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DISCRIMINATION AND COÖPERATION IN FIRE
INSURANCE RATING

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BY

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I.

DISCRIMINATION.

DISCRIMINATION in fire insurance rating has two effects. First, substantial injustice is done to competitors, be those competitors individuals, corporations or cities; second, maladjustment of fire insurance rates has a very serious effect upon the annual fire loss of the country. Not much has been heard of this second effect, but there are reasons for believing that it is of more importance than the injustice which is done to competitors through discriminating rates.

The losses by fire in the United States, direct and indirect, amount to more than half a billion dollars annually. Much attention is being directed to this fire waste, and its causes and remedies are being sought. A great deal is being said about the ignorance of American builders, and of the extravagance of Americans in general in allowing such a tremendous waste to go on, not diminishing in amount, but actually increasing year after year. These accusations are largely unfounded. Nowhere in the world has the art of constructing fire-proof buildings made such progress as in the United States; therefore if Americans build badly, it is for some other reason than ignorance. Americans may be extravagant in their personal expenditures, but better building is a business proposition, and it would be rather difficult to prove that American business men as a rule are not quick to take advantage of ways of saving money in business.

As a matter of fact, a considerable amount of the loss by fire is suffered in the United States because it would be unprofitable to try to prevent the loss. The relative costs of combustible construction and fire-resisting construction have varied so widely that it has been cheaper to build as we have and let buildings, and even cities, burn up occasionally than to attempt to prevent the loss by constructing better buildings.

The principle can be laid down that, in general, if fire insurance rates are properly adjusted, a community will have just that amount of good construction which is profitable for it to have. In other words, the problem of reducing waste by fire is the problem of the cost of fire-proof materials and insurance rates. Prospective builders learn how much different types of buildings will cost; they then find out what the rate of fire premium is on each type and build accordingly. No one can doubt that the rates of fire insurance have a tremendous effect upon the character of construction. If an improvement in construction from the fire standpoint is to be made, it will come as a result of a reduction in the premium rate for insurance. In order to secure the improvement there must be enough saving in the insurance to pay interest upon the additional capital needed for the better construction and enough more to provide a sinking fund to replace the extra capital after a certain number of years. Therefore one of the most important things to consider in discussing the problem of the fire loss is the question of fire insurance rating. If rates measure correctly the various hazards, then the whole attention may be directed to securing cheap fire-proof construction.

Do the rates of fire insurance measure correctly the various hazards? From time to time the charge is made that they do not. Why they do not and what attempts have been made on the part of the companies to make rates conform to hazards, it is the purpose of the present paper to show.

Those who have given the subject of fire insurance rating any thought recognize the extreme complexity of the problem. In life insurance the medical director of each company, in selecting risks, has in mind a standard man—not a physically perfect man, but one who he thinks will live at least a certain number of years.

Every applicant who comes up to the requirement of this standard man is accepted; with most companies, all those risks which do not come up to the standard are rejected. Competition among the life insurance companies in the payment of dividends brings them all to much the same standard. How different it is in the fire insurance business! Where is the standard building, the average risk? Frame buildings have one hazard of burning, brick buildings have another; frame churches have one hazard, frame factories have an entirely different hazard. There is one loss record on frame warehouses that are isolated from other buildings, and another loss record on those frame warehouses which are adjacent to other buildings. Each class of buildings has its own peculiar hazards, and every combination of buildings within each class and with those of other classes has a different hazard; the number of combinations, each producing its own risk of fire, is infinite. Complicate this situation with the hazards of various kinds of occupancy, and the problem of getting at correct fire rates is apparently insoluble. As if this were not enough to make the problem difficult, there is still the change ceaselessly taking place in methods and materials of construction and in the processes carried on within buildings. Human life has experienced some alteration in 2,000 years, but every succeeding phase, at least in modern times, has been marked by a greater longevity. This has made the business of life insurance constantly more secure. In fire insurance the changes in hazards are taking place so rapidly that if the companies had had exact data twenty years ago on which to base rates, they would be nearly useless to-day. The growth of cities, the concentration of population, the building of skyscrapers, the use of electricity for light and power, the changed methods and machinery in factories—all these have created, within a short period, a new world for the fire insurance business.

Lastly, to complicate the rating situation, there are the conflagrations. The nearest analogy, taking such catastrophes into account, would be life insurance companies attempting to carry on their business under the conditions which prevailed in mediæval times in Europe, when terrible epidemics swept over

the country carrying off at times a quarter of the population. To carry on the business of life insurance under such conditions would be well-nigh impossible; yet in the fire insurance field, the conflagrations to-day are almost as disturbing a factor as such epidemics would be in that of life insurance. Feared by all careful managers, subject to no known law of average, they introduce a new complexity into what is already a maze of complexities.

Under such conditions what progress has been made towards securing scientific rating? Space will permit no more than a brief outline of the development which has taken place. In the early history of fire insurance, the rating system was extremely simple. All risks were divided into two classes, brick buildings and frame buildings, and the premium on frame buildings was double that on brick buildings. About 1720, risks in England were divided into three classes and for a century and a quarter this change with but few modifications was all the advance made by English companies towards scientific fire rating. It was in the year 1800 that companies in New York City began first really to classify risks, all risks being grouped under four classes, and a rate fixed for each class. Progress in rating advanced slowly. As late as 1856, more than a century after the establishment of the first fire insurance company in America, a prominent official of one of the companies asserted that nothing more was known about the actual cost of insuring different risks than was known when the first company was established.

Up to 1835, there was not much need for the companies to know the cost of insuring various classes of risks, for up to that time the business of each company had been largely local. Competition was not keen, and the companies simply fixed rates high enough to be sure of a profit. But when the New York conflagration of 1835 and another in 1845 showed the companies that it was fatal to concentrate their business in one locality, conditions became vastly different. The companies began to spread out in order to get a wide distribution of risks. They thus came in contact with each other, competition became intense, and rates went down. How low they could go and still allow a profit to be made the managers of the companies did

not know. As a matter of fact, the rates sank too low, and the companies lost heavily. This keen competition for business, with the consequent fall in profits, had an important effect upon the methods of conducting the business. Managers found it necessary to know more about the cost on various kinds of hazards, and classification of risks was taken up in earnest. To-day all the companies are classifying the risks which they insure, though this activity amounts to scarcely anything inasmuch as no advance has been made over the start given seventy years ago.

After classification of risks, the next step towards better fire rating was the adoption of the system of rating certain classes of risks by schedules. It is not known exactly how schedule rating originated. So far as information is available, one of the earliest if not the first of the applications of the method was made in 1852 by the Philadelphia Board of Fire Underwriters; the schedule adopted was simple and was intended to apply to Philadelphia alone. From that time to this a considerable number of schedules have been worked out by the various underwriting associations; at the present time, many different schedules are in use, though there is a gradual tendency towards the adoption of two, the Universal Mercantile Schedule and the Dean Schedule, the latter being at the present time more popular than any other schedule that has ever been devised.

Schedule rating is, in essence, the attempt to secure scientific rating by an elaborate system of classification. Under this schedule system, rates are made by applying to classes of risks and to individual risks certain predetermined charges and credits based upon the various factors of construction, occupancy, degree of exposure to and of protection against fire. For instance, in getting the rate for a specific building, there is what is known as the basis rate, which is the rate made upon a certain type of building; in one schedule, it is a simple, one story, brick building; in another it is a well-built five story building. The basis rate having been determined, it is applied to the risk to be rated; then the various defects in construction, dangerous factors of arrangement, and deficiencies in the nature and extent of the apparatus for fire protection, are listed with fixed or per-

centage charges for each deviation from the standard; credits are then allowed in the schedule for features of equipment or construction better than those possessed by the standard building. Add the charges to the basis rate, subtract the credits,—the remainder is the rate upon the specific risk. This is schedule rating.

That the system of rating by schedules is a great improvement over the old method of judgment rating is well recognized. Especially is the adoption of the schedule system of importance in securing better construction. Under the system where the special agent is told that the average premium rate on warehouses for the last ten years has been one dollar and thirty-two cents, with a loss ratio of forty-three per cent., and is then sent out to make rates on such buildings, no one can tell what rate his particular building will receive. If a man is contemplating building a new warehouse, or making changes in an old one, and desires, if it pays, to improve the fire hazard by better construction, all that the agent can do is to tell him to go ahead and build, and then a rate will be made. With such uncertainty, no one is likely to consider the fire rates a great deal. Under a system of schedule rating, even one inexperienced in fire insurance matters can take most of the schedules and figure out precisely what reduction in rate will be given for better construction. Will it pay to enclose the elevator wells with brick walls? Look up the schedule and find out; for all is determined beforehand. The schedule system recognizes to a large extent what must be acknowledged, namely, that each building has an individuality of its own. Fire insurance must attempt to measure the hazard of each individual risk, and fit it with a specific rate; and this it does attempt to do through the schedule system of rating.

As has been said, the schedule system of rating is a great advance over the old method of judgment rating; but much remains to be accomplished. If the charges and the credits in the schedule were determined by the known experience of the companies—if shingle roofs, for example, were penalized ten per cent. because the hazard of burning were known to be increased ten per cent. by their presence, and these charges and credits were continually revised in the light of new experience—

the business of fire insurance would have reached its highest development. Such is not the case. Charges and credits are not based on facts; the schedules so far constructed have simply substituted for the judgment of one rating expert, the combined judgment of a number of experts. This can well be illustrated by the history of the Universal Mercantile Schedule: half a dozen different underwriting associations appointed representatives to formulate a schedule; from the thirty-seven representatives appointed, a committee of five was chosen, which made up a tentative schedule representing the pooled judgment of its members; this schedule was then sent out to all the raters in the various Eastern associations asking for suggestions and criticisms, in the light of which the committee went over all the suggestions, combining them as best it could. This process was repeated five times, so that the final schedule is the result of the combined judgments of a considerable number of men experienced in fire insurance matters; but while this method produced a good schedule, the schedule lacks the authority which one based on statistical data would possess.

This explanation of the ways in which rates are determined has been given in order that the following discussion of rate discriminations may be better understood. The fact to be kept in mind regarding all rates, schedule or otherwise, is that they have no statistical basis. To show that the fire insurance companies do not have a scientific foundation for the rates which they charge does not, indeed, prove that the rates are inequitable; unfortunately, however, for the companies, when under charges of discrimination, they cannot prove that their rates are just, save in the aggregate. Such lack of knowledge is bad for the business, for it causes much hostility on the part of the public and results in much unwise legislation.

Most fire insurance experts will readily admit that discriminations abound in fire insurance rating. In fact, the very terminology of the business shows that all classes of risks are not rated according to the risk of loss; almost since the beginning of the business, there have existed what are known as preferred classes of risks and others known as special hazards. This could not be if all risks were rated according to the risk of loss,

for under such conditions, there would be just as much profit in insuring mills, warehouses, and stores, as in writing policies on dwellings and churches. The fact that this terminology of preferred and special classes is not merely the result of a traditional distinction of earlier times, is betrayed by the effort on the part of the companies to secure the preferred classes of risks to-day. In many agencies, ten per cent. more commission is given for preferred business than is paid for premiums on special hazards.

Two interesting questions immediately arise; why is it that the discriminations in rates are made, and how is it that in such a business as freely competitive as is fire insurance the distinction between preferred and special risks can be maintained year after year? It will help us in answering the former query to distinguish various kinds of rate discriminations. First, there is the discrimination between large classes of risks such, for instance, as dwellings on one hand and factories on the other; second, there are discriminations between localities; and, again, there are unjust rates as between specific risks.

Taking up in order these varieties of rate discrimination, we first ask why there are preferred classes of risks. These classes exist because of the desire on the part of the companies to assess rates in such a way as to arouse the least opposition. There are many analogies between fire premiums and taxes; as with governments,—which have always found it necessary to levy taxes with regard not so much to the question of their being ideally just, as to the question of whether they can be imposed without raising a storm of opposition,—so is it with the fire insurance companies. They have found that they can levy high rates on dwellings, on contents of dwellings, on churches, school-houses, public buildings and kindred risks without causing much opposition; and the reason is not far to seek. The rates on dwellings as a class are low, absolutely speaking; few people have large values, so that the premium on each risk is moderate and usually causes little objection to be made. Suppose there is some opposition to the dwelling rates: it may result in a man complaining to his neighbor that the rates on dwellings are too high, and the neighbor may agree with him; but this is about as far as the opposition ever gets. In the same way high rates

on churches, schools and similar property cause little opposition. But how different is the situation if the companies make an increase in rates on mercantile or factory risks! Practically every city has its trade organization, a chamber of commerce, or a board of trade, composed of the leading business men of the city. Even a small increase in rates on risks owned by these men makes a great deal of difference to them, for here values are large. An increase in rates on risks owned by these men means opposition—and opposition which counts, for the organization already exists by which it can be concentrated. The influence which these boards of trade and similar organizations can have upon legislation is so powerful that any rating organization thinks twice before it raises rates upon mercantile and manufacturing risks.

The next question which follows from this description of the condition in fire insurance is why in a business so fiercely competitive as fire insurance there can continue to exist permanent classes of preferred risks. If the old companies are in an agreement to maintain rates, why are not new companies organized to compete for the preferred business, thus bringing rates down to cost? Suppose a company were organized to make a drive for the preferred business. It could get it in two ways: it could either establish new agencies, or it could try to enter into already established agencies. Suppose it chose to establish new agencies, and by reducing rates on dwellings attempted to secure business: about the first man who was approached by the agent of the reduced-rate-on-dwellings company would say, "Reduced fire insurance premiums are just what I want. At what rate can you write my factory?" The agent would have to reply that he could not write the factory at all. The dwelling house owner would answer that, if the agent could not write the factory, he would not change any of his insurance, as the old agent who had always handled his business had had a pretty hard time placing the factory, and it would not be fair to take the dwelling away from him. Thus the agent for the preferred class company would have an extremely difficult task in getting much business.

Suppose then our company, instead of establishing new agencies, attempted to get into established agencies which already control many risks. The local agents have no use for a company which writes preferred risks at reduced rates. A local agent usually represents a number of companies, and any of these is perfectly willing to handle all of the preferred business which the agent controls. The problem with the local agent is, as we shall see, to dispose of his specials. He can do so only by shrewdly mixing them up with his preferred lines. If he gave the preferred business to an outside company, he could not place his less acceptable risks. Thus it is that the local agent refuses ordinarily to represent the reduced rate company, and the company organized to specialize in preferred classes must get business in some other way than by reducing rates.

There are companies which make a specialty of preferred business, but their entry into the field and their success in it has not brought about a better adjustment of fire insurance rates. Rather have they made it worse, for, unable to secure business in either of the ways suggested above, they have purchased it by the payment of excessive commissions. While they have found it impossible to get agents to give them the preferred business by offering to write it at lower rates of premium, they have found it possible to get some agents to give them a share of it at the old rates by offering more commission than the other companies are accustomed to give. By doing this they have not benefited the public by making rates more equitable, for rates have not been reduced; rather have they worked harm by increasing the expenses of the business. Thus are explained the existence and continuance of preferred and special hazards in fire insurance.

The second kind of maladjustment of fire insurance rates is that between different localities. Reference is made to the relative rates between those risks which are subject to the conflagration hazard and those which are not so subject. It has been asserted that if the companies would publish their experience in the ten largest cities of the country, it would be shown that in every one the companies have lost money. That rates should be universally too low in the larger cities, thus encouraging poor

construction where good construction is most needed, is due to a number of causes. In the first place, there are the conflagrations. A conflagration is of such sporadic occurrence that, under the conditions of competition which have prevailed, it cannot be taken into consideration in making rates; that this is true is lamentable, since the best remedy for conflagrations would be the penalty of high insurance rates upon those cities where a conflagration is possible.

The conflagration, however, is not the only cause of unprofitable underwriting in large cities. Even the cities which have not suffered from conflagrations show a balance on the wrong side from the fire insurance standpoint. Another cause must be sought; and it is to be found in the conditions under which the sale of fire insurance takes place in large cities. The city has evolved the fire insurance broker, who is shrewder in many cases than the underwriters with whom he deals. He takes advantage of the ignorance of the companies in not knowing the cost value of the commodity in which they deal, and, pitting one company against another, is able to drive a hard bargain. Yet notwithstanding the unremunerative rates, the large cities are to the average manager tempting ground for work; policies can be written for large amounts and a considerable premium income easily secured. The result is that ambitious managers can scarcely refrain from establishing agencies in the large cities; this makes competition for business severe, and where coöperation among the companies is needed the most to hold off the broker, coöperation is almost impossible because of the number of companies and the number of agencies. Without coöperation, rates are cut and exorbitant commissions given for poor business. Thus it is that in the places where the heaviest penalty ought to be placed on poor construction, the tendency is to make it light, and the day of fire-proof cities is put further away.

We come now to a discussion of the last kind of maladjustment of rates, namely, those discriminations in rates which are made between specific risks rather than between classes of risks as a whole. There are several causes for these discriminations. In the first place, companies frequently accept risks at rates which they know to be grossly inadequate for the risk assumed simply

because they do not wish to offend local agents. To understand how this is so, it is necessary to explain briefly how the agency system is organized. A local fire insurance agent frequently represents from four to twelve, sometimes even twenty different companies; an agent who controls large risks needs to represent that many companies, else he could not place all his insurance without dividing up commissions with other agents. The amount, or the "line," as it is technically called, which one company is willing to write on one risk is limited. When a risk is so large that all the companies in an agency get as large a line as each one wants on the risk, there is no quarrel between them; the conflict of interests arises with the smaller risks, and every company through its special agents is continually urging the local agent to give it a larger proportion of these smaller risks. On the other hand, the local agent has an assortment of risks under his control which no company wants very much at any rate, and a good many risks which none of the companies want at the rate which is offered. And so he takes advantage of the situation and offers to one of his companies a number of choice risks, preferred business, along with a number of risks which are not so choice. The company can take all, or refuse all; for the local agent will not allow it to pick the good and leave the bad. Thus by shrewdly playing one company off against another, and by carefully mixing up his risks, the local agent is able to force the companies to take risks which they ought not to take at the rates which are offered. Of course, if it were not for the existence of the preferred business, the agent could not get the poor risks in, but the preferred business exists, and the manager of the fire insurance company, in order to get his share of it, will accept many risks at inadequate rates.

Another reason why rates on specific risks are not fixed in proportion to the hazard of loss is because the principle of charging what the commodity will bear holds true in fire insurance just as it does in almost every business where there are large fixed expenses. The way in which this element of fixed expenses, with the consequent cutting of rates, enters into the fire insurance business can be shown best by an example. Let us assume that a company has established itself in a large number

of agencies all over the country; to carry on the business profitably, it must have a well-organized force of special agents, and a highly trained home office staff. Under these conditions let us assume further that a risk, say a factory, is offered to the company; the company wants the business, but competition is keen, and a competitive rate must be named. To find out this competitive rate, it is only necessary to analyze the expenditure of the company. The total premium income, in general, is paid out as follows:

Losses	55 per cent.
Commissions	15 " "
Salaries of Special Agents.....	5 " "
Maintenance of Home Office.....	15 " "
Taxes	3 " "
Profit	7 " "

If the burning ratio on the class to which the factory in question belongs is \$0.825 per hundred, in order to get the current rate of profit, to charge the factory its proportion of the fixed expenses and to pay the agent the regular commission, the company would have to name a rate of \$1.50 per hundred on the factory. It will not charge that rate if a lower rate is necessary to secure the business from a rival, and it need not in order to make acceptance of the business profitable; as the expenses for special agents and home office force will continue whether that risk is accepted or not, and both of these can be ignored in making the rate. The tax will have to be paid, and some commission to the local agent, though at times the agent is willing to take a smaller commission in order to induce his company to accept the risk. Therefore, the company can fix a rate of \$1.00 on the risk and still make a profit as follows:

Expected Loss	\$0.825
Taxes03
Commission10

which makes a total expense of \$0.955, leaving a profit of nearly five per cent. to the company upon the transaction even with the heavy reduction in rate. This assumed situation reflects precisely the real condition in the fire insurance world when that business is subject to free competition; it explains the rate wars

which formerly occurred frequently, and which some large insurers and legislators would evidently like to have occur again.

Along with these improper adjustments of rates another allied charge is made against the fire insurance companies, namely, that the companies will not reduce rates readily when hazards are reduced by the adoption of better forms of construction or of fire-preventing devices. Some very good fire insurance men have said that they are not interested in reducing the fire loss; that it is the only function of fire insurance companies to take losses as they find them and assess them on the community. They are right. That is precisely their function; only they must be sure that they take hazards as they find them and not as they do not find them.

It is perhaps safe to predict that the fire insurance companies will never take the lead in encouraging better construction by granting rate reductions for improvements in hazards. There are good reasons for this prediction. In the first place, what reduction in the rate should be given for an improvement in the hazard—say, for example, for the introduction of automatic sprinklers? No one knows until they are tried for a considerable period, and no one is going to try them unless he can get his fire rate reduced; the insurance companies are not philanthropic enough to make the experiment, neither are business men. The result is that only in rare instances are improvements adopted. Furthermore, to one very interested party in fire insurance rating, a reduction in rates means an actual loss in income. Local agents the country over are compensated by means of a commission upon the premiums secured; and a reduction in rates means a reduction in their incomes. As the local agents still play an important part in rate-making, it is contrary to human nature to expect them to become very enthusiastic over rate reductions. Thus it is that neither the companies nor the local agents lead the way in encouraging good construction by offering rate reductions for lessening the danger from fire.

In summing up the situation in regard to fire insurance rates, it has been found that in three different respects rates are not adjusted to the hazard of loss. There are preferred classes of risks; cities are not penalized for their liability to suffer con-

flagration losses; and there are many individual risks taken at improper rates. Such maladjustment of fire insurance rates has two effects: first, it is a serious factor in the business world where competition is severe; second, it has a most important effect upon the amount of the annual waste by fire. That waste alone is becoming so great that strenuous effort should be made to lessen it; and so far as it is increased by improper fire insurance rating, every attempt to secure a better rating system should be eagerly welcomed.

II.

COÖPERATION.

In the preceding section, it has been pointed out that rate discriminations in fire insurance prevail. Such a showing is no reflection upon the ability or the motives of the managers of our fire insurance companies; it is not a result which any of them desires. In fact, the officers of the companies are more directly interested in stopping these rate discriminations than is the public; they would like very well indeed to have some plan devised whereby the fire loss could be equitably assessed on the different classes of risks. Frequently the impossibility of assessing the fixed charges upon some risks has become so general that the fixed charges are not collected at all, and the companies have ended the year with losses instead of gains to their credit. To prevent this situation from recurring and to secure better conditions in the fire insurance world, the companies have found it necessary to work together, to form what are commonly known as fire insurance compacts or combinations. These compacts are of such great importance in the fire insurance business and are the subject of so much public discussion that it will be well for us to analyze carefully the objects for which they are formed, and to find out, if we can, the legitimacy of each object. The companies have coöperated for the following purposes:

1. To regulate rates.
2. To regulate commissions.
3. To secure effective and economical supervision of risks.

4. To study hazards.
5. To repress incendiarism.

Is it to the advantage of the public that the companies should be allowed to coöperate to secure these objects, or is it to the injury of the public? Let us consider each of the objects in order. Is a system of compact rating better for the public than rates made by competition? We have just learned that there are three ways in which discriminations in rates are made. These evils are almost entirely the result of competitive conditions. If the companies could coöperate closely enough they could do away with preferred classes, and increase rates on the special hazards. They do not dare to increase rates on the latter class because they are afraid that the men who own them will go to their legislatures and get laws enacted forbidding all coöperation among the companies. The large cities get relatively low rates because of the competitive conditions; and the third variety of discrimination which has been described is due entirely to competition. If these evils in rating are the result of free competition between the companies, then the way to abolish them is to allow the companies to coöperate in making compact rates.

The second object which the companies have sought to obtain through coöperation is the regulation of commissions paid to agents for securing business. There is almost as much necessity for tariff commissions as there is for tariff rates. There are two ways of increasing the business of a company: one way is to cut rates, and the other is to increase commissions. In many cases the latter method is more successful than the former; to understand how this is true it is only necessary to recall the peculiar organization of the agencies. Instead of a company having in a city an agent who represents it exclusively, it has one who may represent a dozen of its most powerful competitors. This is a situation—a number of rivals having a common representative—found in few other businesses, and the result is competition for business within the agency. If this is unchecked, it takes the form of giving larger commissions for business. A local agent controls a certain number of risks; a special agent may stir him up to solicit more risks and thus increase his com-

pany's business, or the special may offer more commission to increase his company's business at the expense of the competing companies in the same agency. The competing companies retaliate by likewise increasing commissions, and the war goes on until all, or even more than all, the profits go to the agents in the shape of commissions. A union among the companies to regulate commissions has to be formed, or all will become bankrupt.

From the standpoint of the public this commission demoralization is even more serious than is rate demoralization: if rates are cut the public gets the benefit, while in a commission fight expenses may be so increased as to make a rise in rates necessary. With no commission tariff, an improvement in the hazard means only an increased commission paid by some company to secure the business from another company; while losses are reduced, expenses are increased and the net result is the same to the public. Even from this brief discussion of the commission problem it is safe to conclude that coöperation in the matter of commissions is almost as essential as coöperation in rating.

The third object which the companies seek to obtain through coöperation is effective and economical inspection of risks. If rates are ever to be adjusted to hazards, it will come through better inspection of risks. One of the most serious objections which has been raised to present fire rating is that good and bad risks are lumped together in one class and given too nearly the same rate; plainly the only way in which the companies can safely discriminate between good and bad risks is by making a careful inspection of all the risks insured. There is nothing to prevent all the companies from making such an inspection, each for itself, except the expense of doing it. But this is an insuperable difficulty; for if each company were forced to inspect carefully each risk that it insured, the expense of such inspection would probably be much greater than the saving in losses which would result from having rates closely adjusted to hazards. And there is a still more serious objection to inspection of risks by individual companies: no matter how thoroughly a representative of a single company may go about the inspection of risks, he is not going to accomplish much in the improvement of

hazards. Consider the situation as it existed before the companies began to coöperate in inspection. A company's special agent would visit a risk; and though he might see conditions which seriously increased the hazards of fire, yet the knowledge that other companies were anxious to write the risk as it was, and that even a reasonable request on his part would cause ill-will toward his company, would deter him from requiring the removal of defects which he knew to be serious, but which other companies had passed unchallenged. It is the same old story of competition.

How different is the situation when the leading companies coöperated and established inspection bureaus! No matter how many companies are now on a risk, only the authorized representatives of the inspection bureau visit the risk; and since a few men are performing the function hitherto performed by many, experts can be employed, and more efficient inspection is secured. Not only is the inspection more efficient, but the recommendations made carry with them weight far greater than those made by the representative of the individual company. Under the old system, the owner could view with serenity the cancellation of the policy of one company, since he knew that he could get insurance from another; with the companies associated together, the improvements recommended by the inspection bureau must be made, or the policies, not of one company, but of all the union companies will be cancelled. The effect of this coöperation is that improvements have been made; and many classes which were once unprofitable at any rate which competition would allow the companies to secure, have become profitable even at lower rates—a happy situation for the insurance companies as well as for the public.

Very closely connected with the plan of providing for thorough and economical inspection is the fourth object of associated effort, the study of fire hazards and fire prevention. While it is perhaps true that the stock fire insurance companies are not primarily interested in reducing the fire loss, competition of the mill mutuals and of the preferred class companies for certain classes of risks has forced the companies writing all classes to give attention to the study of hazards. Companies

have found that with many classes of risks rates must be closely adjusted to hazards. If they are not, the good mills and factories will go to the factory mutuals, and the better risks in other classes to the non-union, preferred-risk companies which are always looking for profitable business. Therefore in order to forestall competition, actual or latent, the associated companies have found it necessary to establish a laboratory for the study of the hazard of new processes, the value of new methods of fire prevention, and like topics. Here again, it might be possible for one company to make these experiments; but again we may be sure that one company acting alone would not attempt it. It is to the interest of all the companies doing a general agency business to have such studies made of hazards; therefore the companies not only ought to be allowed to coöperate for this purpose, but encouraged to do so.

The last object which the companies have attempted to secure through coöperation is a reduction of losses caused by incendiaries. Each company has to guard itself against the first act of an incendiary; but through coöperation the companies can protect one another from further loss at the hand of the same incendiary. Under the system as carried out at present, whenever a company finds out or suspects that a loss has been due to a desire on the part of some one to sell out to the insurance company at a fancy price, it notifies a central bureau, which sends out to all companies a list of all persons suspected of incendiary tendencies.

Besides the effort to keep track of incendiaries, as above described, the companies' associations seek in other ways to discourage losses due to moral hazard. Rewards are offered for the punishment of incendiaries, suspected criminals are prosecuted, and in other ways a great deal has been accomplished. Since such work is for the good of all the companies, the burden of expense should be borne by all.

What, then, is our conclusion regarding efforts at coöperation among the companies? It is that such coöperation is highly desirable from every point of view.

This conclusion is the exact opposite of that reached by the legislatures of nearly half of our States; twenty-three legislatures have thought that it was detrimental to the interests of the

public that the fire insurance companies should be allowed to coöperate, particularly in the matter of rates and commissions. It was in 1883 that Michigan passed the first of the so-called "anti-compact" laws; this measure provided that no fire insurance company should enter into an agreement with another company, the object of which was to prevent free and open competition between it and other companies. Michigan's action was followed by Ohio and New Hampshire in 1885, by Kansas, Missouri, Nebraska, and Texas in 1889, by Georgia in 1891, by Iowa, Alabama, and Wisconsin in 1897, and by others, until at present (July, 1909), as has been stated, such laws are in force in twenty-three of the States.

There have been a number of motives actuating the State legislatures in passing such laws. The ostensible reason always given has been the fear of a fire insurance trust which would be able to dictate the price of insurance, and which, having this power over rates, would raise them. Admitting for the moment that such a trust is possible, its existence would doubtless be better than a condition of free competition. It is not high rates in fire insurance which cause the greatest evils; the rates which do the most injury are those which do not measure the hazard of loss. Not even the demonstration that a fire insurance trust is possible will justify anti-compact laws.

But there cannot be a fire insurance trust which, because of its ability to dictate prices, is able to secure unusual profits for its members. In order to have a combination with power to dictate prices arbitrarily, such a combination must have a monopoly of some kind. The fire insurance combination, or union, has no monopoly, unless it be the monopoly of experience; and this is the very thing which a compact among the companies makes the common property of anyone who wishes to enter into the business. In order to make a rating compact practicable, there must be printed a tariff of rates upon all risks in every community. It is true that the union companies make a pretense at keeping these printed tariffs from outsiders, but such attempts are wholly farcical; the tariffs are printed, they are placed in the hands of a dozen—sometimes hundreds—of agents, and anyone can learn without a great deal of trouble the rate upon any risk. This is the rate which the well-established companies deem sufficient for

the risk; and thus it is that a new company without experience is able through the printed schedule to take advantage of the experience of the older companies. It has been truly said that instead of a rate union preventing competition, rather is it the nursing bottle for young companies. That it is impossible to establish a fire insurance association or union endowed with dangerous power over rates ought readily to be recognized from the ease with which new companies are organized. No business is easier to undertake than that of fire insurance; no expensive plant has to be acquired as in the case of manufacturing, no expensive right of way secured as for railroading; in most of the States, anyone can organize a fire insurance company and begin business as soon as a cash capital of \$100,000 has been raised. This fact, that companies are so easily organized, represents a very effective control over prices. The best-working fire insurance union in the country has never been able to raise the price of fire indemnity high enough to recoup conflagration losses. If the compacts cannot enable the companies to provide for the conflagration hazard, it seems as if there were little ground for fearing that a fire insurance trust will exercise undue control over rates.

There is reason for believing that agitation against the compacts because of their monopoly feature is simply a cover of other motives for attacking the compacts. Under conditions of free competition in fire insurance, rates, as we have seen, are demoralized; but this is a desirable state of affairs for some insurers. In the first place, with no compacts, rates will be a matter of bargaining, and the shrewdest bargainers in the community will get their insurance the cheapest. Competition among the companies is the keenest for large risks such as are found in the manufacturing and mercantile businesses; and the men in charge of these large business enterprises are in charge because they possess greater ability than do their smaller competitors. The situation, then, in fire insurance with no compacts, is fierce competition for the large risks on the part of the insurance companies, and shrewd bargaining ability on the part of those controlling the risks; and the result is low rates for the large risks. We discover here the reason why large manufacturers and large owners of risks are always found fomenting

anti-compact legislation directed at fire insurance companies, and, to a considerable extent, the reason why that legislation has spread widely over the country.

Perhaps it is unnecessary, in view of what has been said, to describe several periods in our history during which the fire insurance companies were unable to coöperate. We have passed through several such periods. The years 1855 to 1865 were years in which the companies could not get together on rates. There existed that condition of free competition so alluring to the enemies of fire insurance combinations; and what was the result? At the end of 1865, forty-six out of the one hundred and forty-five companies reporting to the New York Insurance Department had impaired their capitals to the extent of a million and a half of dollars; in other words, the stockholders were paying for the privilege of furnishing insurance. Of course such a situation could not continue, for losses cannot permanently be paid out of capital. The crisis was met by a combination among the companies. Supposing such a combination to have been impossible through uniform action of all the States, the life and death struggle must have gone on between the companies until only a few were left. Then the difficulty in securing enough insurance would have sent rates up; then, as rates went up, profits would have increased, new capital would have been attracted to the business, severe competition would have ensued, and the old cycle of events would have been repeated once more. Such a disturbance in business conditions would have been a severe burden upon industry.

Finally, it is interesting to recall the nature of the policy pursued by other countries in regard to fire insurance associations. In England there is one tariff association of practically all the companies, which has enjoyed a continuous existence since 1858; this association determines the rates for all important classes of risks, and so well have rates been adjusted to hazards that owners have never found it necessary to organize mutual companies. The same situation is found in the other European countries. In none are the associations illegal, and in all they are recognized as necessary for the best conduct of the business.

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